

Client Alert

May 17, 2016



SEC Approves PCAOB's Proposed Rules on Audit Engagement Partners; PCAOB Re-Proposes Auditing Standard to Increase Transparency in Audit Reports

On May 9, 2016, the Securities and Exchange Commission (the "SEC") issued an order approving the proposal of the Public Company Accounting Oversight Board (the "PCAOB") to adopt new rules (Rules 3210 and 3211), a new form, and amendments to auditing standards (collectively, the "Proposed Rules") relating to audit engagement partners and other accounting firms that participate in issuer audits.¹ The PCAOB adopted the Proposed Rules on December 15, 2015 and filed the proposal with the SEC on January 29, 2016.² On May 11, 2016, the PCAOB re-proposed its auditor reporting standard, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion* (the "Re-Proposal"), based on comments received after the PCAOB's 2013 proposal and its April 2014 public meeting.³

Pursuant to the Proposed Rules, a registered public accounting firm, when issuing audit reports for an issuer, must file with the PCAOB a report on Form AP that includes the name of the engagement partner and Partner ID, as well as certain identifying information about the auditing firm and information relating to the level of the firm's participation in the audit. The specific information required in the Form AP depends on whether or not responsibility for the audit was divided among other accounting firms and whether the accounting firm participated in at least 5% of the total audit hours. The Proposed Rules generally require the accounting firm to file the Form AP within 35 days after the date the auditor's report is first included in a document filed with the SEC, and within 10 days after the auditor's report is first included in a registration statement filed with the SEC. Firms will continue to file through the PCAOB's existing web-based Registration, Annual, and Special Reporting system.

The Proposed Rules would apply to audits of all issuers, including emerging growth companies, as defined in the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"). They would not apply, however, to audits of a broker-dealer (unless the broker-dealer was an issuer) under Rule 17a-5 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Under the Proposed Rules, registered public accounting firms must disclose the name of the engagement partner in the auditor's report, effective for auditor's reports issued on or after January 31, 2017. Firms must also disclose information about other accounting firms, effective for auditors' reports issued on or after June 30, 2017. In addition to the newly adopted rules and the Form AP requiring the

¹ See SEC Release No. 34-77787 (May 9, 2016), available at: <https://www.sec.gov/rules/pcaob/2016/34-77787.pdf>

² See SEC Release No. 34-77082 (Feb. 8, 2016), available at: <https://www.sec.gov/rules/pcaob/2016/34-77082.pdf>

³ See PCAOB Release No. 2016-003 (May 11, 2016), available at: <http://pcaobus.org/Rules/Rulemaking/Docket034/Release-2016-003-ARM.pdf>

new disclosures, the Proposed Rules would amend PCAOB auditing standards—AS 3101 (AU sec. 508), *Reports on Audited Financial Statements*, and AS 1205 (AU sec. 543), *Part of the Audit Performed by Other Independent Auditors*—to permit an audit firm to voluntarily disclose information about the engagement partner or other accounting firms in the auditor’s report.

On May 11, 2016, the PCAOB issued the Re-Proposal regarding its auditing standard, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*. The Re-Proposal would supersede parts of auditing standard AS 3101, *Reports on Audited Financial Statements*, and it would apply to audits conducted under the PCAOB standards. The Re-Proposal would not apply to audits of broker-dealers reporting under Exchange Act Rule 17a-5, investment companies other than business development companies, and employee benefit plans. The Re-Proposal aims to achieve the same transparency goal as the PCAOB’s original 2013 proposal, but it includes several important changes, based on the numerous comments received after the 2013 proposal and the PCAOB’s April 2014 public meeting. Comments on the Re-Proposal are due to the PCAOB by August 15, 2016.

The Re-Proposal would provide investors with more information about financial statement audits by improving the content and form of the auditor’s report. The Re-Proposal would accomplish this goal principally through requiring that critical audit matters be communicated in the auditor’s report. Under the Re-Proposal, a critical audit matter is any matter that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements, and (2) involved especially challenging, subjective, or complex auditor judgment. By including critical audit matters in the audit report, investors would be able to better understand the methods, considerations, and processes an auditor employed to audit financial statements and other performance measures that would otherwise be unclear where an auditor would be required to use professional judgment and experience to handle complex matters.

As part of the requirement to include critical audit matters in the audit report, auditors would need to take into account several factors in determining whether a matter would be considered a critical audit matter, and auditors would be required to identify any critical audit matters, if any in the report. Auditors would also need to describe the considerations that led to the determination that a matter was a critical audit matter and also how the critical matter was addressed in the audit. Additionally, the Re-Proposal would require the auditors to refer to the relevant financial statements relating to the matter in the audit report.

As compared to the PCAOB’s 2013 proposal, the Re-Proposal would more strongly emphasize critical audit matters, though it would limit the source of potential critical audit matters to those communicated or required to be communicated to the audit committee. The Re-Proposal would also add a materiality standard to the meaning of critical audit matter, relating specifically to those matters that involved especially challenging, subjective, or complex auditor judgment, further narrowing the scope of the requirement from the PCAOB’s original 2013 proposal.

In addition to the PCAOB’s Proposed Rules and Re-Proposal, the PCAOB’s Standing Advisory Group will discuss, in meetings scheduled for May 18 and 19, 2016, the auditor’s role regarding non-GAAP and other company performance measures, the auditor’s reporting model, and how lead auditors supervise other auditors.⁴

⁴ See Press Release, “PCAOB SAG Meeting on May 18-19 to Focus on Non-GAAP Measures, the Auditor’s Reporting Model, and Supervision of Other Auditors” (May 6, 2016), available at: <http://pcaobus.org/News/Releases/Pages/SAG-meeting-agenda-May-18-19.aspx>

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